

RESIDENTIAL UTILITY CONSUMER OFFICE (RUCO)



Serving the Arizona residential consumer since 1983

**TWENTY-THIRD ANNUAL REPORT
2004 - 2005**

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DIRECTOR'S LETTER
RESIDENTIAL UTILITY CONSUMER OFFICE

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Janet Napolitano
Governor

Stephen Ahearn
Director

October 31, 2005

The Honorable Janet Napolitano, Governor
The Honorable Ken Bennett, President, Arizona Senate
The Honorable James P. Weiers, Speaker, Arizona House of Representatives

Re: Fiscal Year 2005 RUCO Annual Report

Dear Governor, President and Speaker:

I am pleased to report the activities of RUCO for the period ending June 30 of this year.

This has been another successful year for our advocacy before the Arizona Corporation Commission. RUCO actively participated in numerous complex rate case litigations and settlement processes and successfully advocated residential consumer positions that were reflected in the Commission's ultimate decisions in those cases.

We realize that RUCO is no longer required to assemble Annual Reports. However, we continually capture data about our activities in an effort to improve our agency performance and in anticipation of future audits and requests for historical agency information. Our continuing to publish this report is a simple and efficient method to memorialize this collection of recent agency data, and requires virtually no incremental time or expense to compile.

Sincerely,

Stephen Ahearn

Stephen Ahearn

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RUCO ADMINISTRATIVE AND SUPERVISORY PERSONNEL

DIRECTOR

Stephen Ahearn was appointed by Governor Janet Napolitano as Director of the Arizona Residential Utility Consumer Office (RUCO) on January 6, 2003. He is a native Arizonan, born on Davis-Monthan Air Force Base in Tucson, and raised in Phoenix. He received his undergraduate degree (B.A., International Relations) from Pomona College in Claremont, California, and his graduate degree (MBA, International Finance) from UCLA.

Mr. Ahearn spent his early career after undergraduate school in operational, finance and management positions for Los Angeles-based manufacturing firms. In the mid-1980's, he moved back to Arizona and co-founded companies that manufactured non-toxic, environmentally-sensitive pesticides, building materials and recycled plastics products.

In 1990 he joined the Arizona Department of Commerce Energy Office as the Manager of Planning and Policy. In that capacity he was responsible for implementation of the legislatively-mandated state Energy Policy. He began to write and speak extensively about electric industry restructuring as early as 1994, and was recruited to the Arizona Corporation Commission in late 1997 to advise the staff on electric industry competitive matters and to act as the agency's liaison to the Legislature.

He left the staff of the Corporation Commission in late 1999 to run for the office of Corporation Commissioner. In the period just prior to being appointed Director of RUCO, he had founded Ahearn & Associates, a consulting firm specializing in general business planning with a focus on renewable energy project development and representation of renewable energy firms.

Since coming to RUCO, Mr. Ahearn has participated in numerous energy-related boards, work groups and task forces at state, regional and federal levels. He chaired the Governor's Working Group on Renewable Energy and Energy Efficiency, and was a member of the Governor's Essential Service Task Force and the Consumer Energy Council of America's 2004 Transmission Forum project. He is currently a committee member of the North American Electric Reliability Council and the Committee on Regional Electric Power Cooperation.

DEPUTY DIRECTOR

Ernest Nedd has been Deputy Director of RUCO for the past two years. He is a native Phoenician who attended elementary school in Phoenix and graduated from Phoenix Union High School. After attending Brown University in Providence, RI, Mr. Nedd served in the U.S. Army, including a tour of duty in Vietnam. Mr. Nedd then returned to Arizona and earned a B.S. degree in Political Science from Arizona State University and a J.D. degree from the College of Law at Arizona State.

Mr. Nedd has previously held positions with the State of Arizona as an Assistant Attorney General, Assistant Commissioner of the Real Estate Department and Chief Hearing Officer of the Department of Liquor Licenses and Control. He has served as a member of the City of Phoenix Board of Adjustment, the Phoenix Inner City Planning Committee and the Phoenix Surface Transportation Advisory Committee. Mr. Nedd also is a former Chairman of the Board of Directors of Valle del Sol, Inc. and he has served on the Board of Directors of the Valley Christian Centers. He currently is a member of the Natural Gas Committee of the National Association of State Utility Consumer Advocates and the Public Interest Advisory Committee of the National Gas Institute.

Mr. Nedd is a resident of the Coronado Historic Neighborhood in Central Phoenix and is active in the Greater Coronado Neighborhood Association.

CHIEF COUNSEL

Scott Wakefield has been RUCO's Chief Counsel since 1998. He came to RUCO after serving as a Hearing Officer at the Corporation Commission, where he handled numerous rate case proceedings, consumer complaint hearings, and matters involving competition in the utility industry.

Mr. Wakefield received his Juris Doctorate cum laude from Arizona State University in 1990, and his Bachelor of Science degree in accounting magna cum laude from Arizona State in 1987. He has served on the board of directors for two non-profit organizations. He grew up and continues to live in Tempe.

Prior to his tenure as a hearing officer, Mr. Wakefield investigated and prosecuted investment fraud with the Corporation Commission's Securities Division. His work there resulted in caselaw outlining when investments in limited liability companies can be considered securities under the Arizona Securities Act.

Mr. Wakefield is knowledgeable on the process to appeal decisions of the Corporation Commission, and lead the first RUCO success in appealing a Commission decision. He participates in RUCO's speaker's bureau, and has made numerous presentations on utility regulation and practice before the Arizona Corporation Commission in legal continuing education seminars.

CHIEF ACCOUNTING & RATES

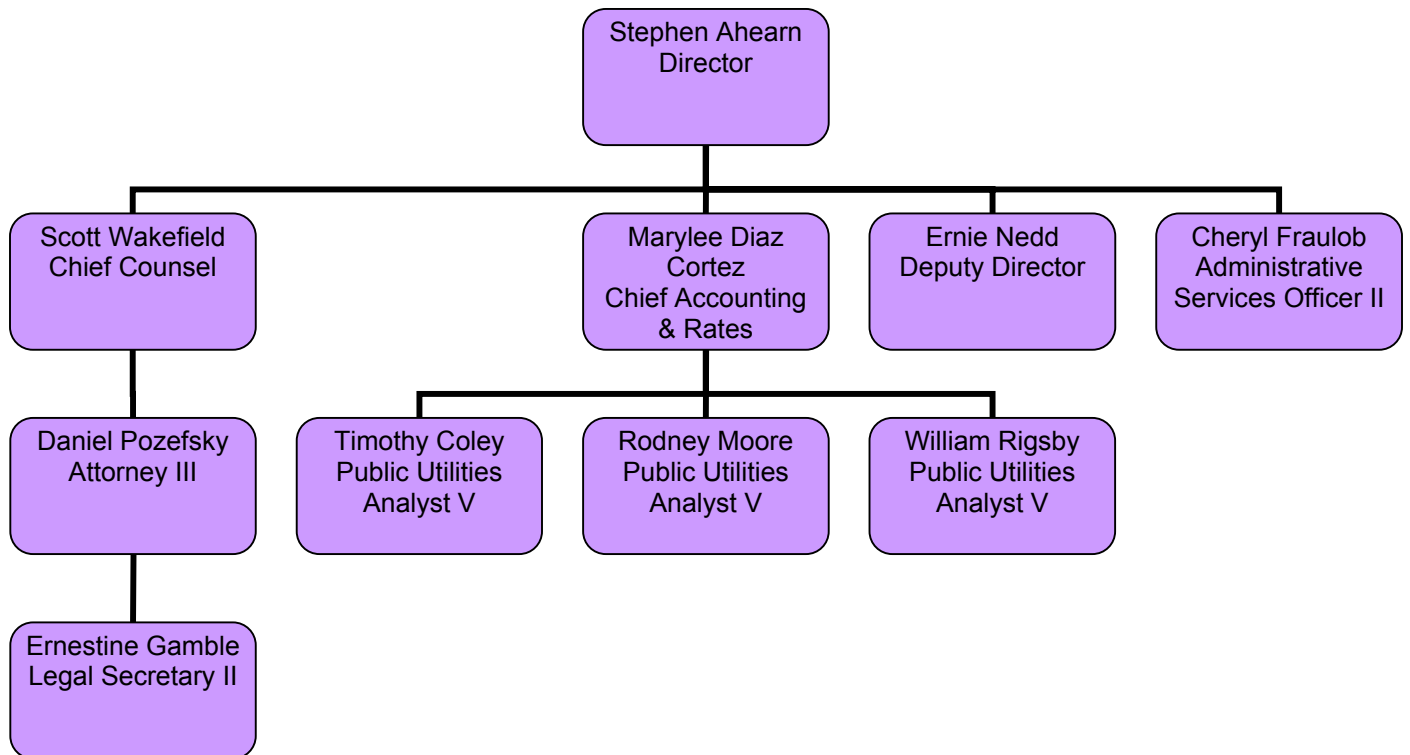
Marylee Diaz Cortez joined the Residential Utility Consumer Office in 1992, and has served as head of the technical division for the past 11 years. She is a graduate of the University of Michigan and a Certified Public Accountant licensed in Arizona and Michigan.

Prior to joining RUCO, Ms. Diaz Cortez worked for the public accounting firm of Larkin and Associates in the Detroit, Michigan area. Her private practice included regulatory consulting services. Between her experience at Larkin and Associates and RUCO she

has audited over 100 public utility companies including electric, gas, telephone, water, and sewer. She has provided expert testimony in as many cases.

Ms. Diaz Cortez works with a staff of three in-house auditors as well as outside expert witnesses. She is responsible for overseeing all testimony filed before the Arizona Corporation Commission. In her 13 years with RUCO, she has worked diligently and successfully to protect consumers from unjust utility rates.

RESIDENTIAL UTILITY CONSUMER OFFICE ORGANIZATION CHART



RUCO AND THE REGULATORY PROCESS

The Residential Utility Consumer Office (RUCO) was established by the Arizona Legislature in 1983 to represent the interests of residential utility ratepayers in rate-related proceedings involving public service corporations before the Arizona Corporation Commission (Commission).

Historically, utilities have had the exclusive right to provide services in designated areas. As legal monopolies, utilities are regulated to ensure that the public is charged just and reasonable prices. To establish the utilities' rates and charges, the Commission conducts public hearings and examines evidence and testimony presented by various concerned parties. RUCO represents the interests of Arizona's residents in these proceedings.

Every utility rate increase application filed with the Commission, regardless of the size of the utility, receives a preliminary review by RUCO. As a matter of policy, RUCO always intervenes and participates in rate cases involving Arizona's largest utilities. Intervention in the cases of smaller companies is decided on a case-by-case basis, with particular attention to the size of the increase sought, the rate history of the utility, and the availability of resources at RUCO. Generally, RUCO does not formally intervene in small cases to avoid causing unnecessary legal expenses for the small utility and its ratepayers.

RUCO is authorized 12 full-time employees, and often contracts with consultants for assistance in analyzing utilities' requests for changes in rates and preparing testimony.

THE RATEMAKING PROCESS

The rates charged by Arizona's investor-owned utilities are established by the Commission. The Commission authorizes a utility to charge rates, which will recover expenditures which are appropriate and prudently incurred, and which provide an opportunity to earn fair return on the utility's capital investment.

A utility initiates the process to obtain a rate increase by filing an application with the Commission. The application must be based on a "test year" of actual expenses and investment during a recent twelve-month period. All of the utility's cost data are drawn from its own records. The Commission requires that the utilities follow a standardized system of accounting procedures that assures that the data can be easily reviewed and verified by the Commission, RUCO and others.

In its application, a utility may propose certain adjustments to its actual test year costs and investment. Historical costs and investment may be adjusted by annualizing changes which occurred during the test year, such as payroll increases or tax changes, making them appear as if they had been in effect for the entire year. In addition, historical costs may be normalized to eliminate the effects of abnormal

variations that actually occurred during the test year, such as weather-related changes in consumption. Other adjustments may be proposed to include the effects of known and measurable changes that occurred after the end of the test year, such as wage increases and certain costs related to recently completed construction projects.

Upon receiving the utility's application and written summary or testimony, the Commission's Staff reviews the application to confirm that it contains all the necessary accounting information. If the application is complete, the Commission's Staff prepares a letter of sufficiency. The determination of sufficiency triggers the Commission's "time clock" rule, which establishes a deadline by which the Commission Staff must file its Staff Report or testimony on the application, and a deadline by which the Commission must issue a final order on the application. A hearing date is fixed for an application that requires a hearing.

After the application is determined sufficient, RUCO and other interested parties are permitted to intervene in the case. As intervenors, parties have the right to obtain additional information from the utility to assist in their review of the application. In addition, intervenors may present evidence of their own on the application and may have their attorneys cross-examine other parties' witnesses and submit written briefs, which present their positions on the issues in the case.

When the Commission Staff has completed its investigation, it issues recommendations in a Staff Report or written testimony. Intervenors also provide their recommendations in the form of written testimony prepared by their analysts or consultants. The utility has the opportunity to respond through the filing of additional written testimony of its own.

In many cases, prior to the hearing on the application, the Commission holds public comment sessions in the service territory of the utility. These meetings are intended to allow customers to express their opinions about the rate request and to provide the Commission with information that the customers feel is relevant to the case. It is not required, nor is it expected, that customers making comments at these meetings be represented by counsel.

The Commission then holds a formal hearing on applications which require hearings. At the hearing, the utility, the Commission Staff, RUCO, and other intervenors present witnesses, offer evidence, and conduct cross-examination of other parties' witnesses on the issues raised in the filed reports and testimony. Issues commonly disputed in rate cases include: which expenses should be charged in rates to ratepayers; what a normal or prudent level of expenses should be; whether all of the utility's investments in physical facilities were prudently made and whether the facilities are needed for the provision of utility services; how much of a return the utility's shareholders should be allowed to earn on their investment; and how the cost of providing service should be allocated to, and recovered from, the utility's various classes of customers.

After the hearing is concluded, the Commission's Administrative Law Judge reviews the evidence and the parties' arguments and issues a Recommended Order. The Recommended Order sets forth a recommended decision on all contested issues and recommends how much of a rate increase, if any, the utility should receive. The parties are permitted to file exceptions to the Recommended Order, asking the Commission to disregard the conclusions of the Recommended Order and suggesting an alternate resolution. At a public meeting, the Commission considers the Recommended Order, and the parties' exceptions to it. The Commission can adopt or deny the Recommended Order as originally written, incorporate any of the suggested exceptions, or make its own amendments.

After the Commission issues its final decision, the parties have twenty days to request the Commission to reconsider its decision. If the Commission declines to grant a rehearing, the parties may appeal the decision to the Arizona Court of Appeals. Decisions of the Court of Appeals may be appealed to the Arizona Supreme Court. Filing an appeal does not prevent the rates approved by the Commission from taking effect.

RUCO'S BUDGET

RUCO receives no money from the general tax fund. Rather, RUCO receives 100 percent of its operating budget from assessments of large utility companies that may, in turn, pass those charges on to their residential customers. In this way, those who benefit from RUCO's work fund its work. The utility ratepayers who pay these small assessments should consider their money well spent. The following reflects FY 2005 activity for the appropriation year 2005, excluding the professional witness budget and the approved amount for FY 2006.

EXPENDITURE CATEGORIES	ACTUAL 2005	APPROVED 2006
PERSONAL SERVICES	\$673,700	\$685,200
EMPLOYEE EXPENSES	\$174,100	\$197,600
ALL OTHER	\$320,400	\$323,400
TOTAL	\$1,168,200	\$1,206,200

RUCO'S FUNDING MECHANISM

Pursuant to A.R.S. § 40-401.01, funding of RUCO is accomplished through an assessment made annually by the Commission. Each utility with annual residential revenues in excess of \$250,000, except those not required to hold Certificates of Convenience and Necessity, is assessed.

The disposition of assessment proceeds is governed by A.R.S. § 40-409. All monies received by the Commission under the provisions of A.R.S. § 40-401.01 are paid to the State Treasurer and placed in the RUCO Revolving Fund. Monies in the fund are used, subject to legislative appropriation, to operate RUCO pursuant to A.R.S. § 40-461. Appropriated funds not spent by the end of a fiscal year do not revert to the General Fund. They revert to the RUCO Revolving Fund and are used to calculate the ratepayer assessment for the next fiscal year. Based on the information available at the end of FY 2005, the assessment for FY 2006 was \$1,206,200.

RUCO'S CASE ANALYSES AND INTERVENTIONS

As previously described, RUCO generally seeks to avoid intervening formally in small rate cases. Nevertheless, these cases are analyzed for potential cost impacts on ratepayers. Generally, rate applications for small utilities do not warrant formal RUCO intervention, which could unnecessarily increase costs to small utility ratepayers. The following table illustrates how RUCO's intervention activity over the past fiscal year compares to prior years:

	2001	2002	2003	2004	2005
NUMBER OF CASES ANALYZED	102	115	92	86	72
NUMBER OF RUCO INTERVENTIONS	11	14	13	13	10

RUCO'S IMPACT

The following table illustrates RUCO's impact on rate requests by utilities over the past fiscal year, compared to prior years:

	2001	2002	2003	2004	2005
AVERAGE UTILITY RATE REQUEST (MILLIONS \$)	33.9	8	10.7	2.2	180.2
AVERAGE RUCO RECOMMENDATION	5.9	1.8	7.8	.9	2.9
AVERAGE ACC APPROVED RATE	4.1	3.0	7.7	1.0	79.4

CONSUMER EDUCATION AND OUTREACH ACTIVITIES

Throughout calendar year 2005, RUCO has continued to engage in several activities designed to reach, interact with and educate residential utility ratepayers. As has been true for several years now, the primary vehicle for this outreach has been the agency's website. During 2005, RUCO has continued to upgrade this website in order to enhance the richness of its content and to make it more user-friendly.

Also throughout 2005, RUCO has continued to publish and distribute a bi-monthly, consumer-oriented electronic newsletter. The RUCO Watchdog is sent to a database of approximately 500 subscribers and contains information about ongoing rate cases and other items that are of interest to the agency's constituents. The Watchdog is published in both HTML and text formats to accommodate individual subscriber preferences.

RUCO maintains a speaker's bureau and responds to groups requesting presentations about the Office. During 2005, RUCO staff members have attended numerous public comment sessions when matters affecting particular communities were pending before the Corporation Commission. RUCO personnel have been present at public comment sessions in Mohave, Yavapai, Santa Cruz, Coconino and Pima counties and these opportunities have been utilized to interact with local residential utility consumers and to provide those consumers with information regarding specific issues in their area.

In the future, RUCO will seek to take advantage of additional opportunities that may become available through technological advances to reach out to larger segments of its constituency in a continuing effort to provide useful information to residential utility ratepayers.

CASE SUMMARIES

(Click [here](#) to review a list of acronyms and terms commonly used throughout the descriptions in these Case Summaries).

ON-GOING CASES

(those not closed by June 30, 2005, listed in order of Docket-opening date).

Arizona-American Water Company, Inc. - Request for an ACRM - Docket No. W-01303A-05-0280

On December 14, 2004, Arizona-American Water Company, Inc., a wholly-owned subsidiary of RWE AG, filed a motion asking (1) that the Commission re-open the record in the Company's most recent rate case (filed on December 13, 2002) so as to consider modifying the final decision by adding an arsenic cost recovery mechanism ("ACRM") and (2) to waive a three-year rate moratorium of a prior order, which approved the sale of Arizona-American to RWE, to include the Paradise Valley Water District in the proceeding. In return for approving the request, Arizona-American agreed to drop court appeals that the Company had filed on both the rate case and RWE orders.

RUCO intervened in the proceeding to insure that ratepayers would not be adversely affected by the implementation of the proposed ACRM.

On July 1, 2005, RUCO filed direct testimony. RUCO witness Marylee Diaz Cortez, CPA, recommended approval of Arizona-American's request with the exception of the Company-proposed hook-up fee for the Lake Havasu district. Arizona-American filed rebuttal testimony on July 21, 2005. Both RUCO and ACC Staff presented oral surrebuttal testimony at the evidentiary hearing that took place at 10:00 a.m. on Tuesday, July 26, 2005, at 1200 W. Washington in Phoenix. The Company presented oral rejoinder testimony during the hearing.

The presiding Administrative Law Judge will now weigh all of the evidence presented in the case and write a Recommended Opinion and Order ("ROO") that will be voted on by the five ACC Commissioners during a scheduled open meeting. The final decision on the Company's request for an ACRM is not expected until sometime in September or October 2005.

Southwest Gas Corporation – Application for a Rate Increase - Docket No. G-01551A-04-0876

On December 9, 2004, Southwest Gas Corporation ("SWG" or "Company") filed an application with the Arizona Corporation Commission ("Commission") for an increase in its rates throughout the state of Arizona.

SWG is primarily a natural gas local distribution company, providing service to over 1.5 million customers in three states. At the end of the test year, SWG served 843,000 customers in Arizona, or over 55 percent of its total customer base.

To date, intervention has been granted to Arizona Community Action Association (“ACAA”), Yuma Cogeneration Associates (“YCA”), Southwest Energy Efficiency Project and the Natural Resources Defense Council (collectively, (“SWEEP/NRDC”), Residential Utility Consumer Office (“RUCO”), Arizona Utility Investors Association, Inc. (“AUIA”), Tucson Electric Power Company (“TEP”), Arizona Public Service Company (“APS”), and the United States Department of Defense (“DOD”).

The major issues in the instant case are:

- The Company’s proposed implementation of a mechanism (Conservation Margin Tracker (“CMT”)) to decouple SWG’s recovery of residential authorized non-gas revenue (margin) per customer from the level of sales.
- The Company is requesting an increase in their gross revenue requirement of \$70,809,128 or 21.93 percent for a proposed annual revenue requirement of \$393,675,106.
- The Company requests a weighted cost of capital of 9.40 percent.

After reviewing the application and analyzing the Company’s response to 36 different data requests from the various intervenors, RUCO filed its direct testimony. Subsequently, as the discovery process continued RUCO reviewed SWG’s rebuttal testimony, other testimonies filed by intervenors and then filed its surrebuttal testimony.

RUCO recommends:

- Disallowance of the CMT.
- Increase of gross revenue requirement of \$48,302,838 or 14.96 percent for a proposed annual revenue requirement of \$371,168,816.
- Weighted cost of capital of 8.64 percent.

At the time of the printing of this report, the parties have filed their testimony, are awaiting the hearing scheduled for October 3, 2005, the issuance of a Recommended Opinion and Order from the Administrative Law Judge and the release of a final order by the Commission.

Chaparral City Water Company – Application For A Determination Of The Current Fair Value Of Its Utility Plant And Property And For Increases In Its Rates And Charges For Utility Service Based Thereon – Docket No. W-02113A-04-0616

On August 24, 2004, Chaparral City Water Company (“Chaparral” or “Company”) filed an application requesting a rate increase for water service. Chaparral provides water service to approximately 12,200 customers in the community of Fountain Hills in Maricopa County, Arizona.

On May 31, 2005, an evidentiary hearing was convened in Phoenix, Arizona.

On September 8, 2005, the Hearing Division issued its Recommended Opinion and Order (“ROO”).

On September 27, 2005, the Commissioners approved at its Open Meeting the ROO.

The issues left unresolved, adjudicated by the Administrative Law Judge (“ALJ”) and approved by the Arizona Corporation Commission (“Commission”) in Decision No. 68176, dated September 30, 2005 were:

Rate Base

Post Test Year Plant:

The Commission adopted RUCO’s recommendation that the total actual cost of \$2,038,443 associated with the Shea Water Treatment Plant Extension (“Shea WTP”) be allowed in rate base.

The Commission also adopted Staff’s recommendation to include the Company’s cost associated with the Fountain Hills Boulevard Main (“the Main”) of \$940,797 in rate base.

The Company had requested the inclusion of two projects as post test year plant in rate base. Staff supported inclusion of the first project, the Shea WTP while rejecting the second project, the Main. Meanwhile, RUCO’s position was to accept the Main and reject the Shea WTP.

Central Arizona Project Hook-Up Fees:

The Commission disallowed RUCO’s recommendation to convert \$220,000 of hook-up fees collected during the test year as contributions in aid of construction (“CIAC”).

The Commission determined the \$220,000 represents test year revenue and not plant additions.

The Commission disagreed with RUCO's assertion that it is the ratepayers, not shareholders, who paid the hook-up fees and it is the ratepayers who should receive recognition for paying the hook-up fees.

Finding And Using Fair Value To Set Rates:

The Commission approved RUCO's methodology for determining the fair value rate of return.

The Commission's traditional approach as recommended by RUCO is to calculate the revenue requirement, then divide it by the fair value rate base ("FVRB") to compute the fair value rate of return.

The Commission utilized a 50/50 weighing of the OCRB and RCND to find Chaparral's FVRB at December 31, 2003, to be \$20,340,298.

Income Statement

Depreciation Expense:

The Commission disallowed RUCO's methodology for determining a typical set of depreciation rates.

The Commission rejected RUCO's approach to averaged depreciation rates, recently approved by the Commission, for 25 different water systems; and adopted depreciation rates developed by Commission's Engineering Division. Chaparral's rates, however, are now among the highest depreciation rates the Commission has recently approved.

Property Tax Expense:

The Commission approved Staff's and Chaparral's methodology for the calculation of the property tax expense. The Commission noted it did not utilize the exact ADOR formula used to determine the Company's actual property tax bill, but rather determined the proper amount of property tax expense for rate making purposes.

RUCO will continue to advance its methodology because it believes the Commission's approval of the Company's methodology is misguided; since it invariably results in an overstated tax expense. The Commission should adopt the RUCO/ADOR methodology and recognize it as the best estimate of property tax expense.

Purchased Power and Water Adjustment Mechanisms

The Commission disallowed the implementation of automatic adjustment mechanisms that would have permitted Chaparral's rates to be adjusted up or down in relation to increases or decreases in purchased water and purchased power expenses.

The Commission decision is in agreement with RUCO's position that the proposed adjustor mechanisms in this case do not meet the constitutional fair value requirement or qualify as an automatic adjustor permitted in relation to fluctuations in certain, narrowly defined, operating expenses.

Cost of Capital

The Commission approved the midpoint between Staff and RUCO variables to provide a reliable and reasonable determination that Chaparral's Weighted Cost of Capital is 7.6%.

Revenue Requirements

The Commission approved an overall increase in revenues for Chaparral of \$1,107,620 or 17.86 percent, for a total revenue requirement of \$7,310,464.

RUCO recommended an increase in the Company's revenues of \$603,988 or 9.74 percent, for a total revenue requirement of \$6,803,753.

Rate Design

The Commission determined it is in the public interest for the Company to implement the conservation-oriented rate design proposed by Staff.

The Commission found that Staff's proposed three-tier rate design appropriately addresses the goals of cost-based rates that encourage conservation while providing that all meter classes bear an equitable proportion of the revenue increase.

Conclusion

RUCO's intervention was instrumental in illuminating its position on several rate making elements; specifically:

The potential of creating mismatches between operating revenues, expenses and rate base by including post-test year plant additions. It is not fair or good ratemaking policy to recognize post-test year improvements in rate base and ignore the resultant savings. The only way to ensure proper matching is to adhere to a historical test year model; with very few exceptions as outlined for the Shea WTP.

The pro forma adjustment of property tax expenses should be based on the ADOR formula; when the formula is varied to project an inflated Fair Value Cash Value increases the risk the Company will over earn.

Arizona Water Company Western Group Rate Case Plan – Docket No. W-01445A-04-0650

On August 14, 2004, Arizona Water Company ("Arizona Water" or "Company") filed an application for a permanent rate increase with the Arizona Corporation Commission ("ACC" or "Commission") for each of the five water systems that comprise the Company's Western Group. The case involves water systems that provide service to customers located in Casa Grande, Stanfield, White Tanks, Ajo and Coolidge.

On October 6, 2004, RUCO filed a request for intervention, which was approved by the ACC's Hearing Division. The case then entered the discovery phase of the proceeding. During this period, RUCO's analysts performed an audit of the Company's books and records and conducted a cost of capital analysis to determine if Arizona Water's proposed increases were justified.

On April 20, 2005, RUCO filed direct testimony containing its recommended level of revenue and return on invested capital. A comparison of Arizona Water's proposed revenue increases and RUCO's recommendations are as follows:

System	Company Requested Increase (Decrease) (\$)	Company Requested Increase (Decrease) (%)	RUCO Recommended Increase (Decrease) (\$)	RUCO Recommended Increase (Decrease) (%)
Ajo Heights	\$88,571	21.64%	\$52,289	12.94%
Casa Grande	\$1,843,802	25.26%	\$15,481	0.21%
Coolidge	\$489,901	35.94%	\$50,532	3.72%
Stanfield	\$11,601	10.07%	\$534	0.46%
White Tank	\$220,188	28.91%	(\$8,568)	-1.13%

The figures illustrated here do not include the amount of increase that will result if the Company's request for an arsenic cost recovery mechanism ("ACRM") surcharge is approved by the Commission. The ACRM will allow the Company to recover costs associated with arsenic removal in order to meet the U.S. Environmental Protection Agency's ("EPA") revised standard of ten parts per billion which goes into effect on January 23, 2006. The ACRM surcharge will impact the Casa Grande, Stanfield and White Tank systems. In addition to the ACRM, the above figures do not reflect any pass through costs for incremental increases or decreases in Arizona Water's purchased pumping power or purchased water costs that are currently being passed on to Western Group customers through the Company's purchased pumping power adjustor mechanism ("PPAM") and purchased water adjustor mechanism ("PWAM") surcharges. RUCO has recommended that the Commission eliminate both the PPAM

and PWAM surcharges. RUCO has also recommended that the Company not be permitted to recover deferred Central Arizona Project ("CAP") water expenses until ratepayers in the Casa Grande, Coolidge and White Tank systems are actually receiving treated CAP water. RUCO is also recommending that \$824,374 in legal costs be removed from the Company's proposed rate base for the Casa Grande system.

Arizona Water filed rebuttal testimony on May 13, 2005. RUCO filed surrebuttal testimony on May 25, 2005. The Company filed its rejoinder testimony on June 10, 2005. Because of settlement negotiations involving the Company's request for CAP cost recovery (and a two-day extension on the original filing date for rejoinder testimony); the formal evidentiary hearing on this case was rescheduled for Friday, June 17, 2005, at 9:30 a.m. Public comment on Arizona Water's requested rate increase was heard on Thursday, June 16, 2005, at 10:00 a.m. prior to a pre-hearing conference at the ACC's Phoenix office at 1200 W. Washington (the original noticed time, date and location for the hearing).

During the evidentiary hearing, which lasted for six days, RUCO's witnesses were cross-examined by Arizona Water's legal team on all of the major issues in the case. RUCO's attorney cross-examined witnesses for the Company, the City of Casa Grande and ACC Staff. The hearing concluded on Friday afternoon, June 24, 2005. Closing briefs and reply briefs were filed, as scheduled, on August 1, 2005, and August 22, 2005, respectively. The presiding Administrative Law Judge ("ALJ") is now in the process of weighing the evidence presented in the case and will write a Recommended Opinion and Order ("ROO") that will be voted on by the five ACC Commissioners during a scheduled open meeting. A final decision on the Company's request for an increase in rates is not expected until sometime in October 2005.

Tucson Electric Power - Filing of General Rate Case Information by Tucson Electric Power Company Pursuant to Decision No. 62103 – Docket No. E-01933A-04-0408

Pursuant to Commission Decision No. 62103, Tucson Electric Power Company ("TEP" or "Company") filed an application with the ACC on June 1, 2004, which presents general rate case information as a rate check on the Company. The filing requirement was part of the 1999 Settlement Agreement (approved in Decision No. 62103) which resolved pending litigation regarding the Commission's Retail Electric Competition Rules, provided TEP with the opportunity to recover stranded costs, implemented two rate reductions, and froze the Company's rates until 2008 (TEP entered into the Settlement Agreement on June 9, 1999, with RUCO, members of Arizonans for Electric Choice and Competition, and the Arizona Community Action Association).

In the application, TEP stated that (based on data collected during a 2003 test year) it was experiencing a revenue deficiency of \$115 million and that the Company could be requesting a rate increase of 16.0 percent. However, because of the rate freeze requirement in Decision No. 62103, TEP did not seek a determination of fair value (for the purpose of setting rates) at this time. Instead, TEP requested that the Commission

schedule a procedural conference to discuss the review of the general rate case information presented in the Company's application and to submit additional information (unrelated to the general rate case information) that had been requested by the Commission in prior decisions.

RUCO filed for intervention on June 10, 2004. During the discovery phase of the proceeding, RUCO's staff conducted an analysis of the Company's application to determine if the information presented in TEP's application was a fair and accurate representation of the Company's performance during the test year ended December 31, 2003. RUCO's staff then filed written testimony that presented the results of its analysis, which is part of the record in the proceeding.

On January 19, 2005, ACC Staff and TEP filed a joint motion requesting a 60-day extension for the filing of direct testimony. On February 10, 2005, the ACC's Hearing Division approved the motion and issued a revised procedural order.

On July 24, 2005, RUCO filed direct testimony containing its recommended level of revenue and return on invested capital. RUCO concluded that TEP is not currently over-earning and that no rate adjustment is warranted pursuant to ACC Decision No. 62103. A comparison of TEP's proposed revenue increases and RUCO's recommendations were as follows:

LINE NO.	DESCRIPTION	COMPANY ORIGINAL COST	RUCO ORIGINAL COST
1	ADJUSTED RATE BASE	\$1,042,088	1,017,055
2	ADJUSTED OPERATING INCOME	24,304	60,465
3	CURRENT RATE OF RETURN	2.33%	5.95%
4	REQUIRED OPERATING INCOME	91,527	79,554
5	REQUIRED RATE OF RETURN	8.78%	7.82%
6	OPERATING INCOME DE(SUF)ICIENCY	67,223	19,089
7	REVENUE CONVERSION FACTOR	1.6612	1.6585
8	IN(DE)CREASE IN REVENUE REQUIREMENT	\$111,670	\$31,658
9	ADJUSTED TEST YEAR REVENUE	702,047	731,814
10	PROPOSED REVENUE	813,717	763,472
11	RETURN ON EQUITY	11.50%	9.61%

Neither ACC Staff, nor RUCO, or any of the other intervenors that filed direct testimony in the case concluded that TEP is over-earning. A procedural conference was held on July 6, 2005, to determine the need for a hearing in the matter. During the procedural conference, the Administrative Law Judge ("ALJ") heard recommendations from ACC Staff, RUCO and the other intervenors on what course of action should be taken. Recommendations ranged from administrative closure (TEP's proposal) to holding the scheduled hearing (RUCO's recommendation). Other intervenors believed that issues such as demand side management recovery and the Adder component of TEP's competitive transition charge should be addressed in the proceeding.

On July 11, 2005, the ALJ issued a procedural order that indefinitely suspends the proceeding in order to provide more time to consider the various positions that were expressed during the procedural conference, to make a recommendation to the Commission, and to allow the Commission time to deliberate.

On September 12, 2005, TEP filed a Motion to Amend Commission Decision No. 62103 (November 30, 1999) to provide for:

1. To extend beyond December 31, 2008, the existing TEP rate freeze at TEP's Base Rate;
2. The retention of the current CTC amortization schedule;
3. An agreement of TEP not to seek rate treatment for certain generation assets; and
4. Effective after December 31, 2008, implement a mechanism to protect TEP and ratepayers from energy market volatility.

At the time this Annual Report was being compiled, the Commission was deliberating on the Company's filing to Amend Decision No. 62103 with the above-mentioned amendments. The Commission has not ruled on the Company's request as to this date.

Qwest Price Cap Plan – Docket Nos. T-01051B-03-0454 and T-00000D-00-0672

In Decision No. 63487 dated March 30, 2001, the Commission approved, with modifications, a Settlement Agreement resolving an application for a rate increase filed by Qwest Corporation ("Qwest" or the "Company"). The Settlement Agreement included a Price Cap Plan as an alternative to traditional rate of return regulation. The Price Cap Plan allows Qwest to adjust prices for various services within certain limitations. The price for basic residential service can be adjusted downward, but not upward. Prices for certain services for which competitive alternatives exist are permitted to adjust upward or downward, within certain boundaries. The initial term of the Price Cap Plan is three years, and the Plan required Qwest to file any proposal to renew the Plan, and any requested modifications thereto, at least nine months prior to

its expiration. Qwest's application in this docket is its proposal to renew the plan with certain modifications.

RUCO analyzed Qwest's application to determine what modifications to the plan the Company is seeking, and the impacts of those modifications on customers. After an abbreviated discovery period, RUCO filed its direct testimony on November 18, 2004. A comparison of the proposed increases in revenue by Qwest and RUCO are as follows:

LINE NO.	DESCRIPTION	COMPANY ORIGINAL COST	RUCO ORIGINAL COST
1	ADJUSTED RATE BASE	\$1,643,000	\$1,489,135
2	ADJUSTED OPERATING INCOME	(5,054)	35,579
3	CURRENT RATE OF RETURN (L2 / L1)	-0.31%	2.39%
4	REQUIRED RATE OF RETURN	11.18%	8.73%
5	REQUIRED OPERATING INCOME (L4 * L1)	183,687	130,001
6	OPERATING INCOME DE(SUF)ICIENCY (L5 - L2)	188,741	94,423
7	GROSS REVENUE CONVERSION FACTOR	1.6876	1.6896
8	GROSS REVENUE INCREASE	\$ 318,525	\$ 159,537
9	CURRENT REVENUES T/Y ADJUSTED	\$1,111,068	\$1,165,053
10	PROPOSED ANNUAL REVENUE (L8 + L9)	\$1,429,593	\$1,324,590
11	PERCENTAGE AVERAGE INCREASE	28.67%	13.69%

Qwest filed rebuttal testimony on December 20, 2004. RUCO's surrebuttal testimony was filed on January 12, 2005. The Company filed its rejoinder testimony (the final round of written testimony in the case) on January 27, 2005.

On Wednesday afternoon, February 2, 2005, Qwest filed a motion with the ACC's Hearing Division requesting that the proceeding be suspended so that the Company could conduct settlement negotiations with ACC Staff, RUCO and all other interested parties. Despite objections from several intervenors, Qwest's motion was granted by the Administrative Law Judge ("ALJ") assigned to the case during a pre-hearing conference that was conducted on Thursday, February 3, 2005. The first settlement meeting was held a week later on Thursday, February 10, 2005, (the date that the evidentiary hearing on Qwest's filing was originally scheduled for).

After meeting with representatives from Qwest, ACC Staff and other interested parties over a period of several weeks, RUCO withdrew from the settlement discussions having reached an impasse on several key issues. RUCO did, however, continue to monitor the progress of the negotiations. On August 23, 2005, the Commission's Chief Counsel filed a signed Settlement Agreement {"Agreement") that had been reached between ACC Staff, Qwest, Cox Arizona Telecom, LLC, the Department of Defense (and all other Federal Executive Agencies), the regulated subsidiaries of MCI, Inc., Time Warner Telecom of Arizona, LLC, the Arizona Investors Utility Association, and XO Communications Services, Inc.

On August 26, 2005, the ACC's Hearing Division issued a Procedural Order laying out the schedule for an evidentiary hearing on the Agreement. Testimony in favor of the Agreement will be filed on September 6, 2005. Testimony in opposition to the Agreement will be filed on October 14, 2005. This will be followed by rebuttal testimony on October 28, 2005. A pre-hearing conference will take place at 11:00 a.m. on October 31, 2005, and the formal evidentiary hearing on the Agreement is scheduled for 10:00 a.m. on November 1, 2005, (both in the hearing room of the ACC's Phoenix Office at 1200 W. Washington). RUCO is presently reviewing the Agreement and will file testimony on October 14, 2005.

After weighing the evidence presented during the proceeding, the ALJ assigned to the case will write a Recommended Opinion and Order ("ROO") on the Agreement that will be voted on by the five ACC Commissioners at a future public open meeting. The Commissioners have the option of voting for the ROO as is, voting for an amended version of the ROO, or rejecting the ROO altogether. A final vote on the matter is not expected until later this year or early 2006.

Electric Industry Restructuring – Docket Nos. RE-00000C-94-0165 and E-00000A-02-0051.

In May 1994, the Commission's Utilities Division Staff (Staff) opened Docket No. RE-00000C-94-0165, to study electric industry restructuring for the State of Arizona. After public input, the Commission adopted new rules A.A.C. R14-2-1601 through R14-2-1616 (Competition Rules) in December 1996 in Decision No. 59943.

In August 1998, the Commission adopted amendments to the Competition Rules on an emergency basis. Included in those amendments were requirements that incumbent utilities divest their generation resources to an affiliate or a third party, and that incumbent utilities acquire power for standard offer customers through competitive bids. In December 1998, the Commission adopted permanent amendments. In January 1999, the Commission suspended the Competition Rules pending further consideration. After taking additional comment on the Rules, the Commission adopted revised Competition Rules in September 1999.

Beginning in December 1998, the Commission issued CC&Ns to a number of competitive Electric Service Providers. Several of the incumbent utilities appealed the decisions granting CC&Ns to the Superior Court. In November 2000, Judge Campbell issued judgment to vacate the Competition Rules and CC&N decisions. A number of parties, including RUCO, appealed Judge Campbell's decision to the Court of Appeals. In January 2004, the Court of Appeals issued its decision finding portions of the rules unconstitutional, finding other portions beyond the scope of the Commission's authority to adopt, finding other portions required certification by the Attorney General, and vacating the CC&Ns.

In October 2001, Arizona Public Service Company filed an application for a partial variance from the Commission's rule requiring competitive procurement of power for standard offer customers, and for approval of a purchase power agreement with APS' affiliate to which it was planning to transfer its generation assets. APS' application was based on its perception that western wholesale electricity markets were unstable and that competitive acquisition of power in that market was imprudent.

In January and February 2002, each of the three Commissioners issued letters seeking information pertaining to the restructuring of Arizona's electric industry. The Commission opened a new docket (E-00000A-02-0051) to examine electric restructuring issues. Interested parties provided responses to the Commissioners' questions, and in March 2002, Staff issued a report and recommended that certain issues be addressed in the new docket.

Prior to considering APS' application for a partial variance and approval of a purchase power agreement, the Commission ordered that certain threshold issues (primarily wholesale market power and the transfer of generation assets by the incumbent utilities) be considered in what became known as Track A of the new generic docket. In addition, the Commission instructed that competitive solicitation issues be considered in a second Track B. A hearing on Track A issues was held in June 2002. In September 2002, the Commission adopted an order resolving the Track A issues. That order found that APS and Tucson Electric Power Company (TEP) have market power in certain areas; that the wholesale electricity market applicable to Arizona is poorly structured and susceptible to possible malfunction and manipulation. The order concluded that the requirement that incumbent utilities transfer their generation assets to others is not in the public interest at this time, and suspended that rule. The Order further required APS and TEP to file necessary modifications to their codes of conduct, and required that a review of the Competition Rules be undertaken.

Track B issues were initially addressed in workshops. A hearing on unresolved Track B issues was held in November 2002, and the Commission issued its order in March 2003. APS and TEP solicited power from the wholesale market pursuant to the requirements of the Track B order. As a result, APS executed three contracts and TEP executed two contracts with alternative wholesale suppliers.

During 2003, the Commission sought comments from interested parties on possible revisions to the Electric Competition Rules. In addition, the Commission held several workshops on environmental risk management to develop criteria to weigh the environmental impact of offers received in future solicitations, and to discuss the costs and benefits of environmental mitigation. In addition, the Commission held workshops to address demand side management (DSM) issues. No final Staff Reports have been issued on these matters yet.

CASES CLOSED IN FY 2005
(listed in order of closing date)

Unisource Merger – Docket No. E-04230-03-0933

On December 29, 2003, UniSource Energy Corporation (UniSource) filed a Notice with the Commission of its intent to merge with Saguaro Acquisition Corporation (Saguaro Acquisition), which would have resulted in UniSource becoming a wholly-owned subsidiary of Saguaro Acquisition's holding company. Saguaro Acquisition would have ceased to exist after the merger, and UniSource would have been the surviving corporation. The stock of UniSource would have no longer been publicly traded. Thus, UniSource would have become a privately held regulated public utility post-merger. UniSource is the holding company of Tucson Electric Power Corporation (TEP), UNS Gas, Inc. and UNS Electric, Inc.

The merger would have involved a total cash price to be paid by a group of investors (Sage Mountain, LLC, KKR, J.P. Morgan Partners and WCP funds) of \$880 million to be financed, in part (\$556.7 million) by equity contributions from the investors. The balance of the \$1.2 billion purchase price, \$660 million, will be borrowed. Also \$263 million of the total purchase price was earmarked to improve TEP's equity ratio from its current 25 percent to 40 percent and to fund the transaction costs.

Among the benefits the Company claimed that would result from the proposed merger, the Company highlighted three:

1. A cash infusion of up to \$263 million into TEP, which would have increased its equity ratio to 40 percent.
2. The commitment to keep UniSource an Arizona-based and operated utility.
3. The continued ability of the Company to provide safe, reliable and adequate service.

RUCO intervened in this proceeding and filed testimony on behalf of ratepayers. RUCO opposed the proposed merger and recommended that the Commission reject it. RUCO analyzed the proposed merger and concluded that 1) the benefits highlighted above by the Company were all benefits that the Company had come along way in achieving and

would ultimately be fully realized in the near term, 2) ratepayers would not realize any incremental benefits from the said unprecedented merger, and 3) moreover, the merger would introduce UniSource to additional financial risk. Specifically, the merger would have increased UniSource's debt leverage placing additional financial pressure on TEP to generate income needed to service UniSource's newly created debt. Additionally, there were no employment contracts in place that would indicate firm commitments by current management to remain after the merger. RUCO asserted that the Arizona Corporation Commission ("ACC" or "Commission") should analyze whether to approve the transaction under both the "no harm" standard of Rule 803(C) and the "public interest" standard. It was RUCO's position that the proposed merger did not meet either standard.

The parties filed their testimony, and a hearing commenced on June 21, 2004. Post-hearing briefs were filed, and the Administrative Law Judge issued the Recommended Opinion and Order to be considered by the Commission.

On January 4, 2005, the ACC rendered a decision to deny the proposed merger on the following findings:

1. We believe the risks of the proposed transaction outweigh the claimed benefits;
2. We find that the proposed leveraged buyout and reorganization of UniSource is not in the public interest.

As Commission Decision No. 67454 established, RUCO's position(s) in the UniSource proposed merger case closely paralleled the Commission's reasoning to reject the proposed merger. RUCO believes its intervention in the case raised many important points of worthy consideration to protect the public interest from possible future harm.

Arizona Public Service - Approval of the Purchase of Generating Assets from PPL Sundance Energy, LLC and for an Accounting Order and Determination of Ratemaking Treatment – Docket No. E-01345A-04-0407

On June 1, 2004, Arizona Public Service Company ("APS" or "Company") and PPL Sundance Energy, LLC ("PPL"), filed a Joint Application ("Application"), requesting: 1) approval of APS' purchase of generation assets from PPL, 2) a determination of the ultimate ratemaking treatment for the assets being acquired, and 3) an Accounting Order authorizing APS to defer for future recovery a portion of the capital and operating costs associated with the transaction. RUCO intervened, filed testimony and actively participated in all of the proceedings.

RUCO took no position on the issue of whether the transaction should be approved. RUCO however, opposed the pre-approval of the ratemaking treatment and approval of an Accounting Order.

A hearing in the matter took place on October 4 and 5, 2004. The Administrative Law Judge ("ALJ") issued her Recommended Opinion and Order and the matter was scheduled for Open Meeting on January 11, 2005. The Commission approved the transaction. RUCO persuasively argued that the Commission should not pre-determine the ratemaking treatment and the Commission denied APS' request for pre-approval of the ratemaking treatment. On the issue of the Accounting Order the Commission agreed with RUCO that under normal circumstances, an Accounting Order would allow APS to benefit where it otherwise should not. However, the Commission concluded that because of the nature of this transaction, some cost inequities unique to this transaction could result, and an Accounting Order deferring these potential inequities for later consideration would be fair in this case

Arizona Public Service Company – Application for an Increase in Rates – Docket No. E-01345A-03-0437

On June 27, 2003, Arizona Public Service Company (APS or Company) filed an application to increase its rates by \$175.0 million¹, or an average of 9.80 percent, to become effective on July 1, 2004. APS indicated that the requested increase includes recognition of the cost of certain generation assets of APS' affiliate Pinnacle West Energy Corporation (PWEC), recovery of \$234 million that APS wrote off pursuant to the 1999 Settlement Agreement of APS' stranded cost application, and recovery of all costs APS prudently incurred to comply with the Commission's Electric Competition Rules.

APS is the largest provider of electric service in the state of Arizona. Based on information provided in the Company's application, APS served 902,000 customers (of which approximately fifty percent are residential customers) in eleven of the state's fifteen counties during the test year ended December 31, 2002 (Test Year).

RUCO's direct testimony on the proposed rate increase was filed as scheduled at 4:00 p.m. on Tuesday, February 3, 2004. RUCO opposed both the inclusion of the PWEC generation assets in APS' rate base and the recovery of the \$234 million that was written off as part of the 1999 Settlement Agreement. The Commission Staff also filed direct testimony on that date, as did other intervenors who are involved in the case. On February 4, 2004, Pinnacle West Capital Corporation (the parent company of APS) stated, in an 8-K filing with the U.S. Securities and Exchange Commission ("SEC"), that it will "vigorously oppose" the recommendations of ACC Staff and RUCO.

Below is a comparison of what APS is proposing in its application, and what RUCO is recommending in its direct testimony:

DESCRIPTION	(A)	(B)	(C)
	APS	RUCO	
	PROPOSED	RECOMMENDED	
	ORIGINAL	ORIGINAL	DIFFERENCE
	COST	COST	[(B) - (A)]
	(\$000's)	(\$000's)	(\$000's)
ADJUSTED RATE BASE	\$4,207,476	\$ 3,051,479	\$ (1,155,997)
ADJUSTED OPERATING INCOME	263,870	258,992	(4,878)
CURRENT RATE OF RETURN (L2 ÷ L1)	6.27%	8.49%	2.22%
REQUIRED RATE OF RETURN	8.67%	7.43%	-1.24%
REQUIRED OPERATING INCOME (L4 x L1)	364,788	226,578	(138,210)
OPERATING INCOME DE(SUF)ICIENCY (L5 - L2)	100,918	(32,414)	(133,332)
GROSS REVENUE CONVERSION FACTOR	1.6529	1.6537	
GROSS REVENUE INCREASE	\$ 166,807	\$ (53,605)	\$ (220,412)
CURRENT REVENUES – TEST YEAR ADJUSTED	1,940,146	1,885,120	(55,026)
PROPOSED ANNUAL REVENUE (L8 + L9)	2,106,953	1,831,515	(275,438)
PERCENTAGE AVERAGE INCREASE	8.60% ²	-2.84%	-11.44%

¹ The Company's proposed jurisdictional revenue requirement of \$166,807,000 plus \$8,283,000 of competition rules compliance charges ("CRCC").

² An average increase of 9.80% when the Company-proposed \$8,283,000 of CRCC charges are included.

Public comment on APS' rate increase request was heard by both the Commission's Chief Administrative Law Judge ("CALJ") and four of the five ACC Commissioners on Wednesday, April 7, 2004. During the public comment session, various individuals, including representatives from a number of Arizona school boards, voiced their concerns on the proposed rate increase.

On Thursday, April 8, 2004, the director of the Commission's Utilities Division informed all of the parties involved in the proceeding that representatives from APS had approached ACC Staff about the possibility of conducting settlement discussions on the proposed rate increase request. APS invited RUCO and all of the other parties to the case to take part in an initial settlement meeting scheduled for April 19, 2004, at the Commission's Phoenix office.

During a procedural conference held at the ACC's Phoenix office on April 28, 2004, the CALJ and all five Commissioners heard from the parties to the case on the results of the two settlement meetings held to date. Attorneys representing the parties to the case stated that they believed that the meetings could produce meaningful results and that the meetings should be continued. Both the CALJ and the Commissioners asked questions of the parties and made suggestions on items such as the possible intervention of state school boards. On April 29, 2004, the CALJ issued a procedural order granting a stay of the proceeding until May 26, 2004.

On Wednesday, May 26, 2004, attorneys for the parties to the case reported to the CALJ and the five Commissioners that progress was being made in the settlement talks. The parties to the case, including RUCO, asked for a continuance of the stay on the procedural time clock until Monday, June 14, 2004. The CALJ stated that she would grant the request and issue a procedural order.

At the June 14, 2004 procedural conference, the ACC's Chief Counsel (speaking on behalf of the parties to the case) requested a thirty-day continuance of the stay on the procedural time clock from the CALJ and two of the five Commissioners. The request was granted by the CALJ.

At a scheduled procedural conference on Wednesday, August 18, 2004, the ACC's Chief Counsel announced that a Settlement Agreement ("Agreement") on APS' request for an increase in rates had been reached by a large majority of the parties to the case including RUCO. The proposed Agreement represents the culmination of approximately seventeen weeks of negotiations by representatives from APS, ACC Staff, RUCO and a wide variety of other intervenors who chose to take part in the settlement discussions.

The Agreement will provide APS with a total revenue increase of \$75.5 million over the Company's adjusted 2002 revenues of \$1.8 billion. This represents a 4.21 percent total increase, 5.59 percent lower than the 9.80 percent rate increase sought by APS in its original filing in June, 2003. APS will be permitted to acquire and include the generation assets of PWECC in the Company's rate base. APS will be permitted to recover the original cost of the PWECC generation assets less \$148 million, which represents a reasonable estimate of the value to APS' ratepayers of the remaining term of the existing power supply contract between APS and PWECC. APS also agrees to forego any present or future claims of stranded costs associated with any of these PWECC assets. APS further agrees to forego any recovery of a \$234 million write-off attributable to Commission Decision No. 61973 that approved the 1999 APS Settlement Agreement. The Agreement provides APS with a 10.25 percent return on common

equity, an embedded cost of long-term debt of 5.80 percent and a capital structure comprised of 55.0 percent long-term debt and 45.0 percent common equity, for a weighted cost of capital of 7.80 percent for the purpose of settlement.

The Agreement also adopts a power supply adjuster mechanism ("PSA") which will allow APS to directly pass the costs of fuel to its customers. Other major points of the agreement include \$16 million in energy efficiency programs, including \$1 million for funding of programs targeted to low-income customers. The Agreement also allows for \$12.5 million in environmental portfolio standard ("EPS") and other renewable energy programs. Finally, the Agreement includes provisions for the competitive procurement of power on the wholesale market, nuclear decommissioning costs, a transmission cost adjuster mechanism (similar to the PSA), distributed generation, and for recovery of costs associated with bark beetle infestation.

A hearing was held on the Agreement beginning on November 8, 2004. All five Commissioners were present and questioned the witnesses at length regarding the terms of the Agreement.

On February 28, 2005 a proposed order was issued which adopted the Agreement with some adjustments. After a three day Open Meeting the Commissioners approved the Agreement as amended and issued Decision No. 67744, dated April 7, 2005.



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APPENDIX

COMMONLY-USED ACRONYMS AND TERMS

The following terms are used throughout the case summaries:

ACC – Arizona Corporation Commission
ACRM – arsenic cost recovery mechanism
ALJ – Administrative Law Judge
APS – Arizona Public Service Company
AZ-AM – Arizona-American Water Company
CALJ – Chief Administrative Law Judge
CC&N – Certificate of Convenience and Necessity
CIAC – contributions in aid of construction
Commission – Arizona Corporation Commission
DEQ – Department of Environmental Quality
DSM – demand-side management
EPS – environmental portfolio standard
FVRB – fair value rate base
OCRB – original cost rate base
PSA – power supply adjuster mechanism
PPAM – purchased pumping power adjustor mechanism
PWAM – purchased water pumping power
PWEC – Pinnacle West Energy Corporation
RCND – reconstruction cost new depreciated
ROO - Recommended Opinion and Order
Saguaro Acquisition – Saguaro Acquisition Corp.
SEC – U.S. Securities and Exchange Commission
Staff – ACC Utilities Division Staff
TEP – Tucson Electric Power Company
UniSource – UniSource Energy Corporation (parent of TEP)

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